

\$300,000 for the year 1964 (computed without regard to section 316(b)(2)(B) and section 562(b)(2)). On December 31, 1964, immediately before the record date of the distribution in complete liquidation, P Corporation owns 100 shares of O Corporation's outstanding stock and individual A owns the remaining 200 shares. All shares are equal in value. The amount which represents P Corporation's allocable share of undistributed personal holding company income is \$100,000 (100 shares ÷ 300 shares × \$300,000), and for purposes of computing the dividends paid deduction, such amount is treated as a dividend under section 562(b)(2) provided that the liquidating distribution to P Corporation equals or exceeds \$100,000. P Corporation does not treat the \$100,000 distributed to it as a dividend to which section 301 applies. For an example of the treatment of the distribution to individual A see example 5 of paragraph (e) of § 1.316-1.

(iv) *Distributions to noncorporate shareholders.* For the rules for determining the extent to which distributions in complete liquidation made to noncorporate shareholders by a personal holding company are dividends within the meaning of section 562(a), see section 316(b)(2)(B) and paragraph (b)(2) of § 1.316-1.

(c) *Special definition of dividend for nonliquidating distributions by personal holding companies.* Section 316(b)(2)(A) provides that in the case of a corporation which, under the law applicable to the taxable year in which or in respect of which a distribution is made, is a personal holding company, the term *dividend* (in addition to the general meaning set forth in section 316(a)) also means a nonliquidating distribution to its shareholders to the extent of the corporation's undistributed personal holding company income (determined under section 545 without regard to such distributions) for the taxable year in which or in respect of which the distribution is made. See paragraph (b)(1) of § 1.316-1.

[T.D. 6949, 33 FR 5529, Apr. 9, 1968, as amended by T.D. 7767, 46 FR 11265, Feb. 6, 1981]

§ 1.562-2 Preferential dividends.

(a) Section 562(c) imposes a limitation upon the general rule that a corporation is entitled to a deduction for dividends paid with respect to all dividends which it actually pays during the taxable year. Before a corporation may be entitled to any such deduction with

respect to a distribution regardless of the medium in which the distribution is made, every shareholder of the class of stock with respect to which the distribution is made must be treated the same as every other shareholder of that class, and no class of stock may be treated otherwise than in accordance with its dividend rights as a class. The limitation imposed by section 562(c) is unqualified, except in the case of an actual distribution made in connection with a consent distribution (see section 565), if the entire distribution composed of such actual distribution and consent distribution is not preferential. The existence of a preference is sufficient to prohibit the deduction regardless of the fact (1) that such preference is authorized by all the shareholders of the corporation or (2) that the part of the distribution received by the shareholder benefited by the preference is taxable to him as a dividend. A corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class. Nor will a corporation be entitled to a deduction for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock. A preference exists if any rights to preference inherent in any class of stock are violated. The disallowance, where any preference in fact exists, extends to the entire amount of the distribution and not merely to a part of such distribution. As used in this section, the term *distribution* includes a dividend as defined in subchapter C, chapter 1 of the Code, and a distribution in liquidation referred to in section 562(b).

(b) The application of the provisions of section 562(c) may be illustrated by the following examples:

Example 1. A, B, C, and D are the owners of all the shares of class A common stock in the M Corporation, which makes its income tax returns on a calendar year basis. With

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the consent of all the shareholders, the M Corporation on July 15, 1954, declared a dividend of \$5 a share payable in cash on August 1, 1954, to A. On September 15, 1954, it declared a dividend of \$5 a share payable in cash on October 1, 1954, to B, C, and D. No allowance for dividends paid for the taxable year 1954 is permitted to the M Corporation with respect to any part of the dividends paid on August 1, 1954, and October 1, 1954.

Example 2. The N Corporation, which makes its income tax returns on the calendar year basis, has a capital of \$100,000 (consisting of 1,000 shares of common stock of a par value of \$100) and earnings or profits accumulated after February 28, 1913, in the amount of \$50,000. In the year 1954, the N Corporation distributes \$7,500 in cancellation of 50 shares of the stock owned by three of the four shareholders of the corporation. No deduction for dividends paid is permissible under section 562(c) and paragraph (a) of this section with respect to such distribution.

Example 3. The P Corporation has two classes of stock outstanding, 10 shares of cumulative preferred, owned by E, entitled to \$5 per share and on which no dividends have been paid for two years, and 10 shares of common, owned by F. On December 31, 1954, the corporation distributes a dividend of \$125, \$50 to E, and \$75 to F. The corporation is entitled to no deduction for any part of such dividend paid, since there has been a preference to F. If, however, the corporation had distributed \$100 to E and \$25 to F, it would have been entitled to include \$125 as a dividend paid deduction.

§ 1.562-3 Distributions by a member of an affiliated group.

A personal holding company which files or is required to file a consolidated return with other members of an affiliated group may be required to file a separate personal holding company schedule by reason of the limitations and exceptions provided in section 542(b) and § 1.542-4. Section 562(d) provides that in such case the dividends paid deduction shall be allowed to the personal holding company, with respect to a distribution made to any member of the affiliated group, if such distribution would constitute a dividend if it were made to a shareholder which is not a member of the affiliated group.

§ 1.563-1 Accumulated earnings tax.

In the determination of the dividends paid deduction for purposes of the accumulated earnings tax imposed by section 531, a dividend paid after the

close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall be considered as paid during such taxable year, and shall not be included in the computation of the dividends paid deduction for the year of payment. However, the rule provided in section 563(a) is not applicable to dividends paid during the first two and one-half months of the first taxable year of the corporation subject to tax under chapter 1 of the Internal Revenue Code of 1954.

§ 1.563-2 Personal holding company tax.

In the case of a personal holding company subject to the provisions of section 541, dividends paid after the close of the taxable year and before the 15th day of the third month thereafter shall be included in the computation of the dividends paid deduction for the taxable year only if the taxpayer so elects in its return for such taxable year. The election shall be made by including such dividends in computing its dividends paid deduction. The amount of such dividends which may be included in computing the dividends paid deduction for the taxable year shall not exceed either:

(a) The undistributed personal holding company income of the corporation for the taxable year, computed without regard to this section, or

(b) In the case of a taxable year beginning after December 31, 1969, 20 percent (10 percent, in the case of a taxable year beginning before Jan. 1, 1970) of the sum of the dividends paid during the taxable year (not including consent dividends), computed without regard to this section

In computing the amount of the dividends paid deduction allowable for any taxable year, the amount allowed by reason of section 563(b) for any preceding taxable year is considered a dividend paid in such preceding taxable year and not in the year of actual distribution. Thus, a double deduction is not allowable.

[T.D. 7079, 35 FR 18587, Dec. 8, 1970]